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The Manufacturers Hanover Financial Digest

Weekly Commentary,
Selected Financial Data,
and Business Indicators

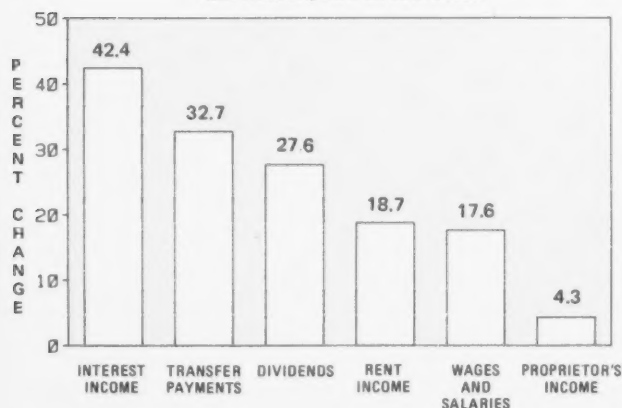
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Personal Income Strengthens

The sizable increase in personal income in July is another indication that the economy, although still weak, may avoid slipping into a recession. Personal income rose a seasonally adjusted 1.6 per cent last month compared with June—the largest monthly advance in a year. However, personal income usually receives a large boost every July as a result of annual cost-of-living adjustments to government transfer payments. This time, almost one-half of the income gain stemmed from increased transfer payments, especially Social Security benefits which rose about \$15 billion.

PERCENT CHANGE IN THE SIX MAJOR
COMPONENTS OF PERSONAL INCOME
(SEPTEMBER, 1979 TO JULY, 1981)



While the sharp rise in transfer payments has been widely publicized, relatively little attention has been paid to the even faster growth of interest income. Although high interest rates have flattened residential construction, contributed to the slump in auto sales and dampened business investment, they have also boosted the incomes of numerous households. Since September, 1979—the month immediately preceding the de-emphasis of interest rate stability as the primary monetary policy objective—interest rates and income have soared. Interest income has risen by more than 42 per cent during this 22-month period, while its share of the total has expanded from 11 per cent in September, 1979 to almost 13 per cent currently. This compares with a 33 per cent increase in transfer payments (see chart above).

Recent improvements in the employment situation boosted wages and salaries—the largest component of personal income. With total employment growing by 0.6 per cent in July month-over-month, unemployment declining and the average workweek remaining unchanged, wages and salaries expanded nearly 0.7 per cent. Although this rate of growth was more than double that registered in June, it was still below the average monthly increase of 0.8 per cent posted during the first five months of 1981.

The Interest Rate Outlook . . .

Short- and long-term interest rates fluctuated within relatively narrow ranges during the past month, reflecting the largely offsetting effects of weakening demand-side fundamentals and continued monetary policy tightness. During the four weeks ending August 19, short-term interest rates increased by an average of 5 to 55 basis points, despite the modest easing of the Federal funds rate. Top-quality corporate yields increased from 25 to 55 basis points during the period, and long-term U.S. government, Federal agency and municipal bond rates all moved higher.

Although the fundamentals of a weakening economy and moderating rates of inflation still suggest lower interest rates in coming weeks, a persistently restrictive Federal Reserve monetary policy and hefty Treasury and corporate borrowing requirements do not. Since little change is expected in the policy stance of the Federal Reserve until all the monetary aggregates are expanding at annual rates well within their 1981 growth target boundaries, any interest rate declines will have to be prompted by a downturn in the demand for funds, rather than increased supplies from the central bank.

In the economy, the pace of overall activity remains weak, with little likelihood that the third quarter numbers will be significantly better than those posted in the second. Among the more recent indicators of the slump into which the economy has fallen was a further drop in the index of leading economic indicators in June (Financial Digest—August 17, 1981) the continuing sluggish pace of new automobile sales, the depressed level of housing starts and a sharp deterioration in U.S. export



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prospects abroad—as reflected in the now five consecutive monthly declines in new export orders for manufacturers' durable goods.

But despite the weakness in the housing and auto industries, it is still not yet clear that the economy is in another recession—and that the demand for funds is about to decline sharply. Personal income, total employment and industrial production continue to expand, ensuring that consumer spending will probably not weaken significantly any time soon. Retail sales rose strongly in July, increasing 1.3 per cent month-over-month (following a 1.7 per cent gain in June) while consumer installment credit outstanding

jumped a seasonally adjusted \$1.93 billion in June. What is more, the current economic weakness may be extremely short-lived. Later this year, the cash flow bolstering impact of recently enacted personal and business tax cuts should boost household and business spending even further. This, together with sharply higher levels of defense spending, could prompt positive economic growth toward year-end.

... Is Still For Lower Rates ...

The rate of inflation continues to moderate and seems to have stabilized on an approximately five to eight per cent plateau. Both the producer and consumer price indexes are now advancing at annual

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 8/12/81	Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	131.661	— .305	+ 5.184
Loans to Depository Inst.	1.271	+ .153	+ .877
Float	3.601	+ .822	— 1.780
Total Reserve Bank Credit	146.168	+ .384	+ 8.086
Treasury Deposits with			
Federal Reserve Banks	3.614	+ .653	+ .275
Currency Outside Banks	124.597	+ .752	+ 7.153
Member Bank Reserves:			
Required	39.882	— .510	+ .577
Excess (Deficiency)	.222	— .157	+ .128
Total Reserves Held	40.104	— .667	+ .705
Net Borrowed Reserves	.826	+ .314	+ .532
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	91.507	— 2.513	+ 6.558
		% Change Since	
		Three Months Ago*	Year Ago
Monetary Aggregates †			
M-1B	434.7	— 2.6‡	+ 7.1‡
M-2 (July '81)	1761.0	+ 5.3	+ 9.1
M-3 (July '81)	2090.8	+ 9.0	+ 11.6
L (May '81)	2476.0	+ 7.2	+ 11.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.

‡ Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 8/21/81			
‡ U.S. Treasury Bills	15.20%	15.20%	14.30%
* Federal Agencies	16.25	16.50	16.00
* Project Notes—Taxfree (46% Taxable Equivalent)	14.54	15.83	NA
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	17.95	17.95	18.15
‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	17.75%	Sep.	17.40%
15- 29 days	17.50	Oct.	17.25
30- 59 days	17.50	Nov.	17.00
60- 89 days	16.75	Dec.	16.90
90-179 days	15.75	Jan.	16.70
180-239 days	15.75	Feb.	16.35
240-270 days	14.00		
‡ Industrial Paper—Prime		† Federal Funds	
30- 89 days	17.38%	Effective Rate	17.55%
90-120 days	17.13		
‡ Discount basis.	* Subject to availability.	† Estimated.	

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period	Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81	\$ 2,882	\$ 2,853
Gross National Product (1972 Dollars)*	2nd Q'81	\$ 1,507	\$ 1,516
Percent Change, Annual Rate	2nd Q'81	— 2.4%	8.6%
Change in Consumer Prices (all urban consumers)*	Jun '81	8.4%	8.4%
Change in Producer Prices*	Jul '81	4.8%	7.2%
Civilian Employment (Thousands of Persons) †	Jul '81	98,962	98,392
Unemployment as % of Civilian Labor Force †	Jul '81	7.0%	7.3%
Personal Income*	Jul '81n	\$ 2,422	\$ 2,385
Leading Indicators Composite Index (1967=100) †	Jun '81	133.8	135.5
Industrial Production Index (1967=100) †	Jul '81	153.4	152.9
Net Change in Consumer Installment Credit †	Jun '81	\$ 1.93	— \$ 2.04
U.S. Merchandise Trade Balance †	Jun '81	— \$ 2.10	— \$ 2.44
Plant and Equipment Expenditures*	3rd Q'81	\$322.88(a)	\$317.29(a)
Private Housing Starts (Thousands of Units)*	Jul '81n	1,055	1,021
New Construction Expenditures*	Jun '81	\$ 236.2	\$ 239.7
Total Business Inventories †	Jun '81	\$ 493.5	\$ 490.3
Total Business Sales †	Jun '81	\$ 353.0	\$ 349.2

* Seasonally adjusted annual rate.

† Seasonally adjusted.

n-Newly reported figure.

a-Anticipated.

rates well below the double-digit level. With each passing month of single-digit inflation, it becomes more likely that inflation expectations will begin to move into better alignment with the price statistics, eventually producing significant money and bond market rallies.

Until then, the rate of inflation is not expected to spike substantially higher any time soon. Prices paid to farmers dropped again in July, marking the seventh consecutive month in which agricultural prices have either remained flat or declined. This suggests that the anticipated big bulge in food prices may still be a few months away—although the food

price component of the producer price index did begin to creep higher in July. Energy price increases should also remain subdued, as long as global demand for petroleum products remains weak. Similarly, housing cost increases may abate once the rise in mortgage interest rates and home prices levels off. More important, however, is the possibility that if the modest rates of inflation registered in recent months persist, and are then translated into lower wage settlements in 1982, this could signal a permanent break in the inflation rate spiral of recent years.

The slowing of real economic activity, together with moderating rates of inflation, should eventually

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week		Change Since Week Ago	Year Ago
Negotiable Time CD's				
Weekly Reporting Banks				
Nationwide (8/5/81)	127,463	+	859	+37,597
New York City (8/5/81)	30,785	-	95	+10,281
Commercial Paper (8/5/81)	154,371	+	227	+31,573

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans			
	Latest Week	Change Since Week Ago	Year Ago
Weekly Reporting			
Large Commercial Banks			
Nationwide (8/5/81)	184,233	+ 3,765	+24,502
New York City (8/5/81)	54,286	+ 2,055	+ 6,652
Total Loans Gross Adjusted			
	Latest Week	Change Since Week Ago	Year Ago
Nationwide (8/5/81)	448,854	+ 6,273	+48,297
New York City (8/5/81)	108,176	+ 3,027	+17,089

Financial Markets

	Friday 8/21/81	Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	16.20%	+ .93	+ 7.14
180-Day Bills†	16.85	+ 1.50	+ 7.20
Longest Bills†	16.56	+ 2.01	+ 6.70
Recent Issues:			
16 ¹ / ₄ s 8/31/81 (When Issued)	16.20	NA	
14s 6/30/85	15.75	+ .19	
14 ⁷ / ₈ s 8/15/91	14.90	- .06	
13 ⁷ / ₈ s 5/15/11	14.65	- .10	
Municipals:			
Bond Buyer—20 Bond Index* (8/20/81)	11.94%	-0-	+ 3.41
Blue List Total (\$ Million)	\$ 800	+ \$ 29	+ \$ 22
30-Day Visible Supply (\$ Million)	\$1,983	- \$ 25	+ \$ 561
Total	\$2,783	+ \$ 4	+ \$ 583
Corporates:			
Moody's Aa Composite (8/20/81)	15.37%	+ .17	+ 3.31
30-Day Visible Supply (\$ Million)	\$7,592	+ \$185	+ \$3,981
Stocks:			
Dow-Jones Averages:			
Industrials	920.57	- 16.36	- 46.15
Transportation	395.79	- 13.08	+ 74.42
Utilities	112.73	- 1.94	+ 1.70
65 Stocks	363.56	- 8.20	+ 15.49
Standard and Poor's 500 Stocks	129.23	- 3.26	+ 3.51
N.Y.S.E. Composite Index	75.10	- 1.90	+ 3.03
N.Y.S.E. Avg. Daily Vol. for Week (000's)	40,764	- 5,274	- 6,640

International Rates

	Friday 8/21/81	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	18.00%	18.13%
1 month	18.38	18.63
3 month	18.63	18.88
6 month	18.63	18.94
1 year	17.75	17.81
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.95%	15.00%
Long Term (7 to 15 yrs.)	14.90	14.90
FOREIGN EXCHANGE SPOT RATES		
New York Opening	U.S. \$	Currency
(8/21/81)	Equivalent	Per U.S. \$
Belgium	.02447	40.86
Canada	.8274	1.2086
Denmark	.1290	7.7530
France	.1694	5.9035
Germany	.4061	2.4623
Italy	.08130	1230.00
Japan	.004380	228.30
Mexico	.04032	24.80
Netherlands	.3657	2.7345
Switzerland	.4673	2.1400
U.K.	1.8660	.5359

* 46% Taxable equivalent 22.11%.

† Bond equivalent.

result in some easing in the growth of short-term business credit demands. Although short-term loan demand did fade considerably in July, much of this softening was reversed in early August. Commercial and industrial loans outstanding at large weekly reporting banks rose a seasonally adjusted \$3.4 billion during the week ending August 5, and at a more than 20 per cent, seasonally adjusted annual rate over the past 13 weeks. However, more than \$2 billion of the increase occurred at New York City and Chicago banks, strongly indicating that much of the rise was due to merger- and acquisition-related loans—which could be transitory.

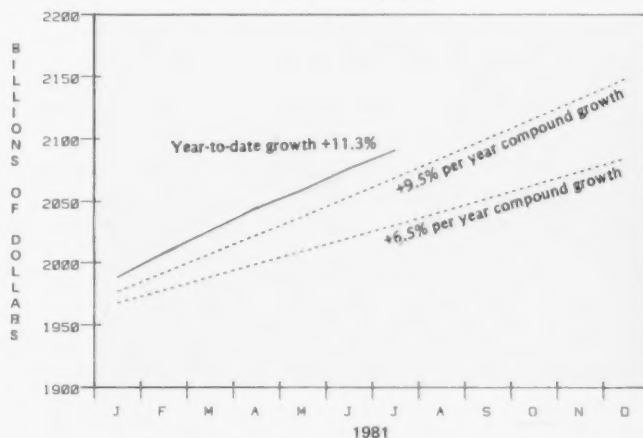
Nonfinancial corporate issues of commercial paper, in contrast, have slowed substantially, rising a seasonally adjusted \$5 million during the four weeks ending August 5. This compares with an almost \$2.6 billion gain in May and June. Still, before interest rates can resume their irregular descent, the growth in short-term credit demands will have to fade much further.

... But The Descent Will Be Gradual

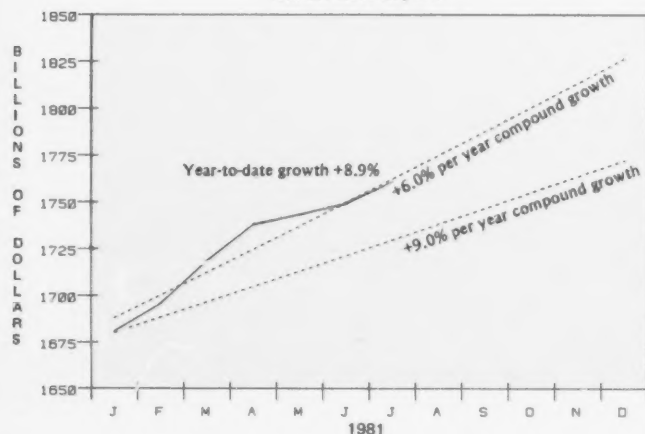
While the slowdown in the economy and the rate of inflation should be prompting somewhat lower

interest rates, they remain stubbornly high. Perhaps most important, this reflects the continuing firm grip on the monetary reins exercised by the Federal Reserve—a policy stance which is unlikely to be altered any time soon. While the growth of non-borrowed reserves has accelerated and pressures on bank reserve positions have eased slightly, it is unlikely that an abrupt and clear-cut loosening of the monetary reins is either underway or imminent.

MONEY SUPPLY, M-3



MONEY SUPPLY, M-2



Although the year-to-date growth of M-1B is still well below its 1981 lower target boundary of six per cent, the expansion of the broader monetary aggregates, M-2 and M-3, remains either near the top or well above their respective 1981 upper growth target boundaries (see charts on this page). Their growth is indicative of the still sizable volume of liquidity in the financial system which, if translated into stepped-up demand for goods and services, could pose a major threat to price stability. As a result, while the subdued growth of M-1B and the weak pace of economic activity must be cause for some concern at the Federal Reserve, the necessity of restricting the growth of M-2 and M-3 is probably cause for an equal amount of concern.